



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Number: **201350044**

Release Date: 12/13/2013

Date: September 17, 2013

UIL Numbers: 501.00-00; 501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller  
Acting Director, Exempt Organizations  
Rulings and Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: July 9, 2013

UIL Number:

501.00-00

501.03-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B =  
D =  
N =  
P =  
S =  
Letter 1 =  
Letter 2 =  
Letter 3 =  
X =

Dear :

We have considered your application for recognition of exemption from federal income tax under § 501(a) of the Internal Revenue Code ("Code") as an organization described in § 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

**FACTS**

You are organized as a nonprofit corporation under state law. Article III of your Certificate of Formation provides:

...the Corporation is organized and shall be operated exclusively for charitable and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code...

Section 1.2 of your Bylaws provides:

The purpose of the Corporation shall be as set forth in the Certificate of Formation. The specific mission of the Corporation shall be to provide innovative, high quality mental

health care for vulnerable children, adolescents and their family to maximize their cognitive abilities, emotional well-being, safety, self-esteem and worldly functioning.

Your application Form 1023 provides that you will seek to provide access to quality mental health care to underserved children and adolescents, including those who have—

1. Brain-based developmental disabilities;
2. Experienced abuse, neglect or other trauma;
3. Experienced placement in foster care;
4. Joined adopting families later than a few months of age;
5. Poverty or near poverty economic status families and need mental health care;
6. Serious mental illnesses or have nuclear family members with serious mental illnesses; and
7. Chronic medical conditions or have family members with chronic medical conditions.

The services that you will provide include psychiatric, psychological, neuropsychological assessments, best practice psychotherapeutic interventions and psychopharmacologic interventions.

To accomplish your mission, you will—

1. Provide high quality, developmentally appropriate, and evidence-based care in an integrated and interdisciplinary model of care delivery.
2. Embed mental health services into existing nonprofits, public agencies and primary care settings that serve the target population.
3. Create flexible staffing, programming, and partnerships to be responsive to community need.
4. Advance the training of practitioners of psychiatry, psychology, nursing and social work in the delivery and administration of mental health services.
5. Establish and further prevention and early intervention programs that enhance children's and family's mental well-being and resiliency (including in partnership with existing agencies).
6. Create sustainable funding through private and government sources to provide these services.
7. Provide clinical and programmatic consultative services to agencies and practitioners that serve the target population.
8. Seek research grants focused on mental health interventions that benefit the target population.
9. Advocate for community mental health practices and policy initiatives that enhance the availability, comprehensiveness, and quality of care.
10. Incorporate a program evaluation and improvement component to measure and maximize impact.

In Letter 1, you revised the narrative description of your activities by adding that "all services provided by applicant will be provided by licensed medical providers (including psychiatrists and

other mental health professionals) who are not employees of [applicant] but who are operating pursuant to service agreements as independent contractors."

B is your Executive Director and Medical Director. In Letter 1, you state that—

B is currently rendering services free of charge. It is anticipated that in the future he may receive annual payments in the indicated amount pursuant to a Medical Director Agreement. Under the Medical Director Agreement, B will render services as an independent contractor. In such capacity, applicant will in no way control or restrict the exercise of B's independent medical judgment.

You provided a revised Part IX (Financial Data) of your Form 1023 to reflect the fact that amounts paid to officers are being paid as professional fees pursuant to an independent contractor agreement and not as compensation.

In Letter 2, you state that you will contract with medical professionals (physicians) to provide services on site at "partner" agencies. Your current partner agencies are P and S. You do not bill patients for mental health services. Rather, you receive a negotiated "consulting fee" from each partner agency. With respect to the consulting fee charged to S, you state—

The consulting fee currently charged to S for the services of a child and adolescent psychiatrist is \$7x/hour. This fee represents a discounted rate. The undiscounted rates charged by local private practice child and adolescent psychiatrists range from approximately \$12x-\$20x/hour depending on the service provided.

With respect to the consulting fee charged to P, you state—

The fee currently charged to P by N is \$96x/month. The weekly services provided are two half-days of service provided by an advanced nurse practitioner specializing in mental health and approximately 1.5 to 2 hours of service and supervision by a child and adolescent psychiatrist, plus on-call coverage.... The agreed fee represents a substantial discount from standard marketplace charges. In addition ... the agreed fee covers Applicant's conduct of a pilot program for teen mother residents of P to teach these young mothers empathic attachment to their children....

In addition, Applicant provides training and program planning services for both of these partner agencies without additional charge. Training and program-planning time ranges from 3-10 hours a month at present.

Exhibit C to Letter 2 is a letter written by D, who serves as healthcare regulatory counsel to you. In that letter, D renders a legal opinion on the issue of whether the manner in which you provide professional health mental services complies with the State's prohibition on the corporate practice of medicine. D writes—

N may not legally employ psychiatrists or other licensed physicians (as employees) because doing so would violate [the State's] prohibition on the corporate practice of

medicine.... The [corporate practice of medicine] doctrine does not prohibit a non-physician or a non-physician entity from entering into an independent contractor arrangement with physicians so long as the non-physician or non-physician entity does not split fees with the physicians, does not control and is not in a position to exercise control over the physician's independent medical judgment.

N is not a physician or otherwise permitted under [State] law to employ physicians in the practice of medicine. It may engage physicians on an independent contractor basis to provide medical services so long as it does not share fees with the physicians, have the right to or attempt to exercise control over the physicians' independent medical judgment.

At N's request, we have drafted the attached professional services agreement template for the entity to engage physicians and other licensed health care professionals on an independent contractor basis, to provide mental health services to children and adolescents.... The draft agreement provides that the physician ("Contractor") is an independent contractor and shall utilize independent professional judgment in the care and treatment of patients. It further provides that N shall neither have, nor exercise control or direction over the methods by which the Contractor performs his/her work. The hourly fee to be paid to the Contractor is calculated to reimburse the physician for his/her professional services. Under the agreement, the physician's compensation is lower than standard rates [in] the community. The lower amount is consistent with the below-market rates that N agreed to in its agreements with S and P, which allow it to provide mental health services to a greater number of underserved children. By way of example, N receives \$7x per hour from S for physician services, pays the physician \$5.25x per hour, and retains \$1.75x to cover administrative costs.

Exhibit E to Letter 2 is an unexecuted "Medical Director Agreement" between you and B, under which B agrees to serve as your Medical Director. Article 5.2 of the Agreement provides that "It is the intent of the parties ... that Medical Director shall not be deemed to be an employee of [Applicant] for any purpose whatsoever...."

In Letter 3, in response to our question – "What percentage below your actual costs do you provide services to S and P?" – you provide additional information about your "fee generating activities." You explained that—

Applicant's independent service providers are successful clinicians whose separate, for-profit practices ... serve private patients who pay market rates. Applicant has requested that these clinicians provide services to at-risk populations at rates that are significantly below market.... The rates currently being paid by Applicant to its independent contractor physicians is approximately 50% below market rates.... Applicant's administrative costs are quite low.... Based upon the strength of Applicant's board of directors and indications to date of general community support, Applicant believes that when it obtains its determination letter, Applicant will be able to generate donations and grant income in excess of its fee revenue and will therefore be able to provide services at less than one-half of the cost of such services.

Letter 3 also mentions that your present and proposed activities include educational, training and research activities. You estimate that "30-35% of Applicant's time is devoted to administering its contracts with P and S, and 65-70% of its time is devoted to the other [consultation and advocacy initiatives]."

## LAW

Section 501(a) of the Code exempts from federal income taxation organizations described in subsection (c).

Section 501(c)(3) describes corporations organized and operated exclusively for charitable, religious, educational, and other specified exempt purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Rev. Rul. 69-528, 1969-2 C.B. 127, concerns an organization formed to provide investment services for a fee exclusively to organizations exempt under § 501(c)(3). The ruling states that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit. If the services were regularly provided by one tax-exempt organization for other tax-exempt organizations, such activity would constitute unrelated trade or business. Thus, the ruling holds that the organization is not described in § 501(c)(3) since it is regularly carrying on the business of providing investment services that would be unrelated trade or business if carried on by any of the tax-exempt organization on whose behalf it operates.

Rev. Rul. 71-529, 1971-2 C.B. 234, concerns an organization formed specifically to assist § 501(c)(3) organizations to manage more effectively their endowment or investment funds. Membership in the organization is restricted to colleges and universities exempt under § 501(c)(3). Its board of directors is composed of representatives of the member organizations. Most of the operating expenses of the organization are paid for by grants from independent charitable organizations. The member organizations pay only a nominal fee for the services performed. These fees represent less than fifteen percent of the total costs of operation. The ruling states that, by providing the services described above to its members, the organization is performing an essential function for charitable organizations. By performing this function for the organizations for a charge that is substantially below cost, the organization is performing a charitable activity within the meaning of § 501(c)(3). Consequently, the ruling holds that the organization qualifies for exemption under § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, concerns an organization formed to provide managerial and consulting services for nonprofit organizations exempt under § 501(c)(3) to improve the administration of their charitable programs. The organization enters into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The ruling states that the provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable. Accordingly, the ruling holds that the organization's activities are not charitable and, therefore, the organization does not qualify for exemption under § 501(c)(3).

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. This case is the basis of § 1.501(c)(3)-1(c)(1) which provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

In Paratransit Ins. Corp. v. Comm'r., 102 T.C. 745 (1994), the Tax Court addressed the issue of whether an organization which provided automobile insurance to a group of exempt organizations under § 501(c)(3) qualified under the § 501(m)(3)(A) exception to the definition of "commercial-type insurance." In analyzing whether the taxpayer satisfied the "substantially below cost" threshold, the court relied heavily on Rev. Rul. 71-529. Under that standard, the court held that an arrangement whereby an organization's members, for the taxable years 1988-90, contributed 60.43, 79.90, and 83.96 percent, respectively, of the total costs of providing insurance "comes nowhere near the mark" of evidencing substantially below cost services.

In Nonprofits' Ins. Alliance of Calif. v. United States, 32 Fed. Cl. 277 (1994), the court held that an organization formed by nonprofit exempt organizations to administer a group self-insurance risk pool, and to provide insurance to members at the lowest possible cost, was not exempt under § 501(c)(3). The court, observing that the plaintiff's members had contributed as little as 47 percent of the total costs of operation, said that "contributing 47 percent of costs ... does not satisfy the policy underlying the 'substantially below cost' analysis. Such a figure is neither the 'nominal fee' described in Rev. Rul. 71-529, nor does it manifest donative intent.

## ANALYSIS

You contract with mental health professionals ("Contractors") who agree to provide professional services to you at reduced rates. In turn, you offer the services of these Contractors to nonprofit clinics and public agencies that serve underserved children and adolescents. In return for the services provided by the Contractors, the clinics and agencies pay you a consulting fee. This



fee is set at an hourly rate sufficient to cover the cost to you of the Contractor and your administrative costs.

While it may be the case that your Contractors provide their services at a fee below what is customarily and reasonably charged in private practice, the provision of professional services at less than market rates does not, in itself, render such services "charitable." Furthermore, you have made it clear that the Contractors provide such services in their capacities as independent contractors and not as your employees or agents. You acknowledge that if the Contractor's services were attributed to you, you would be in violation of the State's prohibition on the corporate practice of medicine. Consequently, the Contractor's services, even if such services were deemed to be in furtherance of charitable purposes, would not be attributed to you for purposes of determining whether you are engaged primarily in activities which accomplish any of the exempt purposes specified in § 501(c)(3).

Since the mental health services provided to clinics and agencies are carried on by independent contractors and not by you, we must consider whether your actual activities – negotiating agreements with clinics and public agencies on behalf of your Contractors, and administering those agreements – furthers any purpose described in § 501(c)(3). The Internal Revenue Service (the "Service") has recognized the exemption of organizations that provide administrative services to organizations exempt under § 501(c)(3) at *substantially below cost* on the theory that such an organization is, in effect, similar to a grant-making charity assisting the recipient organizations in carrying out their charitable programs. For example, in Rev. Rul. 69-528 it was held that an organization providing investment services to a group of unrelated § 501(c)(3) organizations for a fee did not qualify for exemption under § 501(c)(3) because such activity would be considered an unrelated trade or business if regularly provided by one tax-exempt organization for another tax-exempt organization. On the other hand, in Rev. Rul. 71-529 it was held that a somewhat similar organization qualified for § 501(c)(3) exemption on the grounds that it was controlled by the organizations that it served and charged only a nominal amount for its services (i.e., fees represented less than fifteen percent of the total cost of operation). Finally, in Rev. Rul. 72-369 it was held that an organization providing managerial and consulting services to § 501(c)(3) organizations at cost did not qualify for exemption under § 501(c)(3). The ruling states that it is not sufficient that the organization served only exempt organizations and that its operations were not designed to show a profit. The provision of commercial services at cost would not provide a basis for exemption under § 501(c)(3).

Insofar as your services to P, S, and other clinics and public agencies are of an ordinary commercial and administrative nature, they will not be considered to further charitable purposes unless they are furnished solely to § 501(c)(3) organizations at substantially below your cost. You guess that, as a tax-exempt organization, you would be able to generate donations and grant income in excess of fee revenue and would therefore be able to provide services at less than one-half of the cost of such services.

In Paratransit Ins. Corp. v. Comm'r, the court concluded that revenues of 60 to 84 percent of expenditures did not evidence substantially below cost services. In Nonprofits' Ins. Alliance of Calif. v. United States, the court concluded that charges equal to 47 percent of costs did not satisfy the substantially below cost standard. Thus, while you hope that tax-exempt status

would enable you to provide services to clinics and agencies at less than one-half the cost of such services, even one-half of cost is neither a "nominal fee" nor does it manifest a donative intent. Therefore, your activities on behalf of P, S and other clinics and shelters would not be activities that further charitable purposes within the meaning of § 501(c)(3).

While we recognize that you also engage in non-fee generating consultations and advocacy initiatives that may or may not further exempt purposes, you devote, by your own estimate, 30 to 35 percent of your time to administering your contracts with P and S. Thus, your non-exempt activities on behalf of P and S are not an insubstantial part of your total activities. The Supreme Court, in Better Business Bureau of Washington, D.C. v. United States, said that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Insofar as we find that your activities with respect to your Contractors, P, and S do not further exempt purposes and are not insubstantial, we conclude that you have a substantial non-exempt purpose that precludes you from being recognized as an organization described in § 501(c)(3).

Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3) and you must file federal income tax returns. Contributions to you are not deductible under § 170.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Service will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of

Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the I.R.S.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to this address:

Internal Revenue Service

NCA:  
1111 Constitution Ave, N.W.  
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Karen Schiller  
Acting Director, Rulings and Agreements